

Trade Agreement Trade-offs

International trade tribunals challenge state law and policy.

By William T. Waren

Blackjack, roulette, baccarat, craps, poker. It's all available on the Internet. And some state legislators don't like it. Many states are cracking down on Internet gambling in response to concerns about organized crime, money laundering, gambling by minors and the effect of gambling on public morals generally. But now, some state legislatures and law enforcement officials find that they themselves may have broken the law—international trade law that is—by seeking to curb Internet gambling.

As it happens, the United States crackdown was a major blow to the Internet gambling industry on the island nation of Antigua and Barbuda, population 67,000. In 2001, 119 offshore Internet casinos employing 5,000 people operated from the Caribbean islands. Today, after the crackdown, fewer than 30 online casinos, with fewer than 1,000 employees, are still operating.

So, Antigua and Barbuda sued the United States in an action brought before a World Trade Organization (WTO) tribunal, alleging that federal law and the laws of all 50 states regulating Internet gambling violate international trade law.

In late March, the WTO tribunal issued a confidential interim ruling and found that measures adopted by U.S. federal and state governments that restricted Internet gambling violate the WTO's General Agreement on Trade in Services (GATS). The United States is now appealing the decision.

The reaction to the WTO ruling was swift. "This unwarranted interference by an international body in domestic legislation erodes our sovereignty," says U.S. Senator Jon Kyl of Arizona. "It has absolutely nothing to do

with free trade, but would deny us the right to set our own social policy."

Many state legislators also express concern about the Antigua case and similar cases brought against the United States based on allegations that state law and policy violate international law. But they also often argue for a balanced response that takes into account the benefits to American business and the economy that are promised by the North American Free Trade Agreement (NAFTA), WTO and other agreements.

Representative Peter Lewiss of Rhode Island puts it this way: "We support international trade agreements that generate jobs and economic growth in our communities, provided that the agreements respect the constitutional and traditional authority of state governments."



REPRESENTATIVE
PETER LEWISS
RHODE ISLAND

THE LIMITS TO STATE POWER

As the Antigua case demonstrates, NAFTA, the WTO and subsequent trade agreements, the so-called "post-1994 agreements," do place limits on state government. Prior to 1994, states had little reason to monitor the course of trade negotiations closely because they focused on tariffs, quotas and similar "at the border" discrimination against foreign products, almost always the business of the federal government. The post-1994 agreements deal not only with "at the border" discrimination, but also impose strict

TRADE TALK

Articles on trade are sprinkled with alphabet soup. Here's a key to some of the initialisms.

WTO—The World Trade Organization was adopted in the Uruguay round of negotiations in 1994. It is both the mechanism for negotiating new multilateral agreements for trade in goods or services and the forum in which disputes under multilateral agreements are decided. It is headquartered in Geneva, Switzerland.

GATT—The General Agreement on Tariffs and Trade dealt exclusively with trade in goods and the lowering of tariff barriers. It was folded into the WTO during the 1994 negotiations.

GATS—The General Agreement on Trade in Services establishes multilateral agreements on service industries, such as telecommunications and insurance, under the auspices of the WTO. GATS is an ongoing negotiation.

NAFTA—The North American Free Trade Agreement is a regional free trade area established in 1994 that includes Canada, the United States and Mexico.

USTR—The U.S. trade representative is a federal executive office charged with leading U.S. negotiating teams for all bilateral, regional and multilateral trade negotiations.

rules related to government regulation, taxation, purchasing and economic development policies that are regarded as non-tariff barriers to trade by the drafters of the agreements. In other words, a large number of measures within state policy jurisdiction are now affected by international law.

In addition, the pre-1994 agreements had no effective enforcement mechanism. But NAFTA, the WTO agreements and other post-1994 agreements (in combination with federal implementing legislation) do. The federal government may bring lawsuits to

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UNINTENDED CONSEQUENCES: EXPROPRIATING STATE SOVEREIGNTY

preempt state and local measures found to violate international law (though private suits are barred). Or even if the feds decline to sue, legislatures may be compelled to repeal or amend state law simply as a result of the political and economic pressure resulting from WTO or NAFTA sanctions. In this sense, with their power to authorize sanctions, WTO and NAFTA serve the “constitutional” function of regulating legislatures at the federal, state and local levels. Indeed, Renato Ruggiero, the past director general of the WTO, has been widely quoted as saying, “We are writing the constitution of a single global economy.”

International tribunals that find state laws to be in violation of international trade agreements now have the power to authorize retaliatory trade sanctions, like higher tariffs on U.S. exports, until the United States complies. In investment cases under NAFTA's Chapter 11 and similar agreements, tribunals can order the United States to pay monetary damages. For example in one NAFTA Chapter 11 case, *Methanex v. United States*, a Canadian corporation is seeking \$1 billion in damages from the United States because of its alleged loss of future profits resulting from the California Legislature's ban on the toxic gasoline additive MTBE.

RECENT AND PENDING CASES

Methanex is only one of several NAFTA investment cases that have proved controversial. NAFTA's Chapter 11 on investment is novel among international agreements in several respects. International litigation may be initiated by private parties, usually transnational corporations, without working through trade ministries. Failure to comply with the agreement can result in uncapped awards of money damages that are automatically appropriated from the U.S. Treasury. Tribunals meet in secret. And the legal standards for protecting investor and property rights are vague.

They arguably sweep far more broadly than the protections for business and property rights found in the U.S. Constitution, such as the Fifth Amendment's “takings” clause.

Local government officials in the United States, as represented by the National League of Cities and similar associations, have expressed serious concern that NAFTA's investment chapter gives foreign investors greater rights, particularly with respect to complaints about local zoning and land use

What's an investor's biggest fear when deciding whether to plunk down big money for a new processing plant in a foreign territory? He fears expropriation, nationalization or other seizure that not only deprives him of any revenue from the property, but also of the property itself, in a political or judicial system that offers no recourse.

This is not likely to happen in Great Britain, Germany or Japan, but it has happened in other parts of the world. And many businessmen worry that it could happen again.

Ambassador Robert Zoellick, the U.S. trade representative (USTR), often says that “capital is a coward.” So in the face of fears of expropriation, how do you coax capital out of the safe and secure United States and into more risky places where it can make more money, improve trade and bolster economic and political development?

One solution is the “investor-state dispute resolution” process that serves this purpose for businessmen, but may have the unintended consequence of infringing on state sovereignty.

First elaborated in Chapter 11 of the North American Free Trade Agreement (NAFTA), the investor-state dispute resolution process offers companies that feel their property or profitability are hampered by government action the opportunity to bring a claim. It will not be heard in U.S. court in full view of the free press, but instead will be reviewed by an ad hoc international tribunal that meets behind closed doors. Although the U.S. federal government has to pay any cash awards, many of the cases that foreign companies have brought against the United States under NAFTA Chapter 11 have related to state environment, health and public welfare laws or constitutional processes. So far, the United States has not lost a case. But states fear that a decision against the United States could one day translate into preemption of state law or other infringements on state authority.

A classic example is *Methanex Corp. v. United States*, where a Canadian corporation claimed nearly a billion dollars in compensation from the United States for lost profits as a result of a California statute that effectively banned the use of the fuel additive MTBE. California outlawed the fuel additive because it contaminated drinking water supplies. The dispute resolution tribunal originally made several rulings in favor of the United States. But late last year, Methanex asked the tribunal to revisit its decision and is seeking access to state documents regarding how it arrived at the measure. Methanex's latest petition is under review.

Using NAFTA's Chapter 11 as a blueprint, variations of the investor-state dispute resolution mechanism continue to be interwoven into new trade agreements: Singapore, Chile, Central American Free Trade Area and Morocco. But state groups continue to have concerns.

Earlier this year, the National Conference of State Legislatures, along with other organizations representing state and local officials, convinced the U.S. trade representative to exclude the dispute resolution mechanism in the trade pact with Australia.

This victory will be the exception rather than the rule. But state and local organizations will continue to work with USTR to develop a provision that protects American investors while also protecting state sovereignty and authority.

“States need to get aggressive,” says Oklahoma Representative Clay Pope. “No one expected NAFTA to produce the results it did. Legislators must protect the role of the states.”

—Jeremy Meadows and Nick Steidel, NCSL

regulation, than are provided to U.S. property owners under the U.S. Constitution. The concern of local officials became acute after a NAFTA tribunal's decision in a case called *Metalclad v. Mexico*.

In *Metalclad*, Mexican state and local officials used their authority over land use regulation and business permitting to stop a U.S. multinational from operating a hazardous waste facility. It was on top of an aquifer that provided drinking water to a town in the state of San Luis Potosí. Metalclad then brought a suit against Mexico under NAFTA's

Chapter 11, claiming that the company's property rights had been violated. A NAFTA tribunal agreed that Metalclad's rights had been violated and directed the Mexican national government to pay \$16.5 million in damages. The Mexican federal government paid and is now seeking to recover its costs from the Mexican state and local governments that stopped Metalclad's operation.

A similar case, *Glamis Gold v. United States*, is pending. It involves a claim that a California land use regulation violates NAFTA's investment chapter.

CONSULTING WITH STATES ON TRADE

When the Office of the U.S. Trade Representative (USTR) begins to negotiate an international agreement, a broad cross-section of federal officials is involved. But typically state governments are not represented. So how do states have their say?

State and local officials serve on USTR's Intergovernmental Policy Advisory Committee on Trade (IGPAC). Utah Representative Sheryl Allen, Alabama Representative Johnny Ford, Rhode Island Representative Peter Lewiss, Oklahoma Representative Clay Pope and Hanna Shostack of New Jersey's Office of Legislative Services are NCSL's members on the committee.

As negotiations begin, the committee highlights issues of importance to states. When agreements are completed, it reports state and local perspectives so Congress has that information when adopting implementing legislation.

USTR also consults with states through the "single point of contact" (SPOC) system. Recommended by governors, the contact person is usually the state chief economic or trade development officer. USTR information is sent to them for dissemination and to elicit input during negotiations. You can find your state's SPOC at www.ustr.gov/outreach/spoc.htm

State legislators also can take advantage of several unofficial methods to have their say. USTR's Office of Intergovernmental Affairs and Public Liaison welcomes legislative input. The office works with representatives of state and local government and keeps them informed of the current status of trade agreement negotiations and their effects.

USTR is also amenable to working with state and local officials on specific issues. Idaho Representative George Eskridge, for example, chairs an unofficial working group on energy that is discussing electric utilities, state policies and industry regulation, and USTR's negotiations on the subject in the next round of GATS talks. Eskridge says the discussions are beneficial to the trade negotiators, as well as "helpful to me in designing Idaho's energy policy to fit with international trade agreements."

—Jeremy Meadows, NCSL



SENATOR
LIZ FIGUEROA
CALIFORNIA

"California laws are already being challenged under these trade rules," says California Senator Liz Figueroa, who chairs a special committee conducting oversight investigations on the impact of international trade and investment agreements on state legislation.

"Just a few months ago, the Canadian gold mining corporation, Glamis Gold, used NAFTA investor rules to claim that California's mining law protecting Native American sacred sites interfered with their right to future profits," she says. "Should Glamis prevail in this \$50 million case, California could be forced to change the law in question. This has been a grim wake-up for those of us who are concerned about preserving democracy at the state and local level."

Perhaps no group of state officials, however, has been more dismayed by certain NAFTA investment cases than chief justices. Through their association, the Conference of

Chief Justices, they have asked Congress to act "to preserve the integrity of the courts of this country and their ability to adjudicate fairly and finally the rights of all parties who seek justice in them."

The chief justices' concern results from two recent cases that, while dismissed on the merits, made clear that international tribunals have the right to consider claims from foreign investors that U.S. court decisions violate NAFTA investment rules.

Chief Justice Margaret H. Marshall of Massachusetts was unaware until recently that a Canadian real estate firm, which the state high court had ruled against and which had been denied review by the U.S. Supreme Court, was able to sue under NAFTA's Chapter 11 for monetary compensation for the acts of the Massachusetts court.

"To say that I was surprised to hear that a judgment of this court was being subjected to further review would be an understatement," Marshall said in an interview with the New York Times.

A BALANCING ACT

Going back to the Antigua and Barbuda on-line gambling case, the WTO ruling came as a surprise to many policymakers and scholars. But not to Georgetown Law Profes-

COMMITTEE IS LEGISLATURES' VOICE ON TRADE

The NCSL Standing Committee on Economic Development, Trade & Cultural Affairs monitors international trade negotiations and works with the U.S. trade representative and other federal agents. Its members lobby Congress on state-federal trade policies. See the committee's Web site at www.ncsl.org/standcomm/scecon/scecon.htm

If you have questions about the implications of trade agreements on states, call Jeremy Meadows or Nick Steidel in NCSL's Washington, D.C., office at (202) 624-5400.

sor Bob Stumberg who has long argued that Antigua and Barbuda might very well be successful. "Global trade and investment agreements," Stumberg says, "are designed to limit the sovereignty of American states."

And certainly they are written to reduce the number and variety of possible barriers to trade. These often include policies or regulations in the 50 different states or the thousands of American municipalities.

"A paramount virtue of federalism," argues Stumberg, "is that cities and states serve as the 'laboratories of democracy.' That tradition of experimentation, progressive change and diversity creates the potential for conflict with international agreements that promote uniformity on a global scale." In fact, the European Union has argued that the local-global conflicts that emerge from the U.S. federal system amount to "market fragmentation."

Another leading scholar of trade and federalism finds these developments less alarming. University of Nebraska Professor Matt Schaefer says that "the conscientious legislator must ask the question whether the legislation he or she crafts or votes on is in conformity with the additional constraints imposed by international trade agreements."

Stumberg makes a point similar to Schaefer's but with a different spin. "The challenge for state and local legislatures," he says, "will be to develop their ability to respond to the layering global rules on top of our federal system."

In particular, Stumberg compliments legislatures in Washington, California and Idaho for establishing effective oversight of international trade and investment agreements. These states have focused not simply on

STATES STUDY TRADE POLICY

compliance, but also on educating the Office of the U.S. Trade Representative, Congress and the public on trade and federalism issues.

This is particularly important, Stumberg says, because international trade laws, such as the investment, services, subsidies and procurement regimes that seek to constrain state legislatures, are still at an early point in development. The vague text of the NAFTA and WTO agreements is still being interpreted and elaborated. Also major new agreements, like the proposed Free Trade Area of the Americas, are still being negotiated.

HOT TOPICS

Utah Representative Sheryl Allen says that it is particularly important for legislators to

TRADE IS VITAL TO AGRICULTURE

Trade agreements that open markets and lower tariffs are essential to farmers and ranchers. Foreign markets account for 25 percent of the nation's farm income. More than \$55 billion in U.S. agricultural products were exported last year.

"We have to expand international trade," says Oklahoma Representative Clay Pope, who raises beef cattle. "It pumps all sectors of the rural economy."

Seventy percent of all U.S. almonds are sold overseas. Foreign markets purchase 65 percent of all sunflower oil, 60 percent of cattle hides and 60 percent of dried plums. Half of the wheat and rice crops are exported.

Trade agreements open foreign markets to these goods, but they don't necessarily protect products from being blacklisted. When bovine spongiform encephalopathy (BSE) was discovered in Washington state, Japan banned American beef. The loss? \$100 million. And the market is still gone.

But without trade agreements, exporting as well as importing any product is difficult. Tariffs, customs and duties, sanitary standards, and international shipping requirements all are determined through trade agreements.

"Everything in the world now affects the small farmer, from the price of oil to patent law in Argentina," says Texas Representative Pete Laney, who grows cotton.

—Doug Farquhar, NCSL

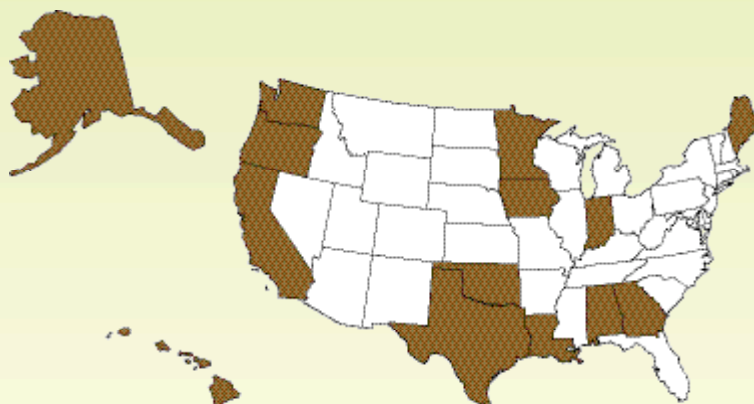
Although foreign policy and international commerce are the domain of the federal government, a few state legislatures have formed committees to examine the complex interplay of international trade and state policy. In Texas, the Senate's Committee on International Relations and Trade is charged with examining the North American Free Trade Agreement and the state's unique economic relationship with Mexico.

The California Senate Select Committee on International Trade Policy and State Legislation weighs the various impacts of international trade agreements on state laws. It explores what the appropriate relationships should be between states and the federal government when international trade policy intersects with traditional state roles. Committee members keep an eye on issues of environmental protection, natural resource management, human rights protections and public safety.

During their interim session, the Washington State House of Representatives' Trade and Economic Development Committee will discuss offshore outsourcing, what impact current trade agreements are having on the state, the role of the state trade representative and any possible related legislation. Maine passed a bill this session that established a public commission to advise legislators regarding the economic impact of trade agreements on the state.

—Nick Steidel, NCSL

STATES WITH COMMITTEES ON TRADE AGREEMENTS



Legislatures in 14 states have established legislative, executive or public commissions to examine international trade agreement implications for the state.

Source: National Conference of State Legislatures, May 2004



REPRESENTATIVE
SHERYL ALLEN
UTAH

pay attention to upcoming negotiations regarding the expansion of the WTO's General Agreement on Trade in Services. "Legislators must understand the importance of these upcoming negotiations on energy and other services," she says.

The procurement chapters of upcoming trade agreements like the Central American Free Trade Agreement also are hot topics.

The Office of the U.S. Trade Representative (USTR) has requested that governors bind their state to the procurement rules in upcoming agreements that would limit state anti-outsourcing policies.

Representative Lewiss of Rhode Island sums up the views of many legislators on this debate. "Legislators continue to have strong concerns about the effect that these agreements have on American principles of federalism, state sovereignty and lawmakers' ability to address the concerns of their constituents."

At the same time, Lewiss says, U.S. trade negotiators are willing to work with state and local officials. He is confident that we will "find language and understanding that will allow us to wholeheartedly support efforts to expand international trade opportunities." ■